COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY FRONTIER GAS COMPANY, LLC FOR APPROVAL OF ADJUSTMENT OF FARM TAP RATES	)))	CASE NO. 2011-00513

O R D E R

On December 20, 2011, Kentucky Frontier Gas Company, LLC ("Frontier") filed an application seeking approval to adjust the rates charged to customers taking service pursuant to KRS 278.485 from the gas gathering systems it operates. In recent years, Frontier has acquired a number of small gas systems, including gathering systems with farm tap operations. The gathering systems with farm tap customers are Alert Oil and Gas Company, Interstate Gas Company ("Interstate"), Kinzer Gas, KLC Enterprises, and Quality Gas Company. For practical purposes, Frontier acquired the customers of these systems and the meters serving these customers. The systems retained their drilling operations and ownership of the gathering lines. As it did not acquire the drilling operations, Frontier must purchase gas in order to serve these systems' customers. Frontier's rate proposal had two purposes: (1) to increase total revenues; and (2) to consolidate the rates of the different systems into one common rate schedule.

BACKGROUND

Frontier is a Colorado-based corporation formed for the purpose of acquiring and operating small gas systems located generally in eastern Kentucky. Its Kentucky office is located in Magoffin County, Kentucky. On all the gas systems Frontier has acquired, it serves approximately 3,400 customers, including roughly 625 farm tap customers. Of these farm tap customers, about 450 pay tariffed rates while the rest take gas via contracts that specify either fixed rates, rates based on a published index, or free gas service.

All of these farm tap customers, except for the Interstate customers, were acquired when Frontier purchased Belfry Gas, a local distribution company.[1] Frontier acquired Interstate in a transaction separate from the Belfry Gas acquisitions. The Belfry Gas systems' rates include a minimum bill for the first Mcf used and volumetric rates for all additional Mcf that currently range between $7.45 and $13.05. Interstate's rate includes a minimum bill for the first Mcf and a volumetric rate for all additional Mcf of $14.40.

In its December 21, 2011 application, Frontier stated that due to the fact that it did not own any drilling facilities, it was seeking a deviation from 807 KAR 5:026(9), the regulation that governs requests for rate adjustments by farm tap systems operating under KRS 278.485. Frontier submitted its rate request pursuant to 807 KAR 5:001(10), the regulation governing general rate applications, and requested several deviations from the filing requirements contained therein. The Commission's January 17, 2012 Order permitted Frontier to file its application under 807 KAR 5:001(10) and granted the deviations from the regulation as requested by Frontier.

In its application, Frontier proposed an effective date of March 1, 2012 for its proposed rates. By Order dated January 30, 2012, the Commission suspended the

[1] Frontier also refers to the Belfry Gas systems as the Kinzer operations, which is the last name of their previous owner.

proposed rates for five months, up to and including July 31, 2012. That Order also established a procedural schedule for processing this case which included two rounds of data requests to Frontier, intervenor testimony, one data request to intervenors and a public hearing, if necessary. There were no intervenors in this proceeding. Frontier responded to one data request from Commission Staff ("Staff") and participated in informal conferences with Staff on March 28 and May 14, 2012. The record is complete and the matter now stands submitted for a decision.

TEST YEAR

Frontier developed its rate request based on the results of operations for the 12-month historical period ended June 30, 2011. The Commission finds the use of this proposed test period to be reasonable. In using a historic test period, the Commission has given full consideration to appropriate known and measurable changes.

FRONTIER'S RATE PROPOSAL

In response to a Staff request for information, Frontier revised its initial rate proposal.[2] The revised proposal includes a $10.00 monthly customer charge and a per Mcf volumetric rate of $7.44, which includes a base rate of $3.84 and a gas cost of $3.60 per Mcf.[3] As is typical, the proposed customer charge will be billed regardless of a customer's usage as compared to the minimum bill contained in the existing rate structures of these farm tap systems, which covers a customer's usage of zero to one

---

[2] Frontier initially proposed a $10.00 monthly customer charge and a volumetric rate of $7.63 per Mcf. The volumetric rate included a base rate of $3.45 per Mcf and a gas cost of $4.18 per Mcf.

[3] Frontier based its revenue requirement on a 0.88 operating ratio, a method often employed by the Commission in rate cases of small privately-owned utilities. The Commission believes the operating ratio methodology is appropriate for Frontier in this proceeding.

Mcf. A customer charge is favored by both gas and electric utilities as it enhances revenue stability during off-peak seasons of the year.

Frontier's revised rate proposal included five adjustments: (1) an increase in maintenance expense of $7,676, from $37,537 to $45,213; (2) an increase in customer records expense of $1,048, from $21,288 to $22,336; (3) a decrease in outside services expense of $10,800, from $16,514 to $5,714; (4) an increase of $11,115, from $22,260 to $33,375, in administrative salaries expense; (5) and an increase of $1,632, from $2,712 to $4,344, in pensions and benefits expense.

The increase in maintenance expense reflects an increase, from six to seven, in the number of operators employed by Frontier and a pay raise for those operators. The increase in customer records expense, likewise, reflects a pay raise for the employees performing that work. The decrease in outside services expense and the increase in administrative salaries reflect a reclassification of compensation for Frontier's manager and an accounting correction, while the pensions and benefits expense increase reflects higher medical and pension costs.

Frontier's revised rate request used a factor of 12 percent to allocate operating expenses to its farm tap systems. This reflects Frontier's paying farm tap customers as a percentage of its total number of tariffed customers, which is 14.0 percent, blended with Mcf sales to its paying farm tap customers as a percentage of its total Mcf sales to all customers, which is 10.2 percent. Using a 0.88 operating ratio, Frontier calculated a base rate revenue requirement of $171,421 for its farm tap operations.[4]

---

[4] Adjusted test year operating expenses of $318,249 less gas costs of $167,399 equal $150,850. $150,850 / 0.88 = $171,421.

Pro Forma Adjustments Summary

Eliminating its purchased gas expense and gas cost revenue from the results of its operations (based on the presumption that its test year gas cost revenue exactly matched its test year gas costs of $167,399), the effect of the adjustments on Frontier's net income is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$ 295,094	$(167,399)	$ 127,695
Operating Expenses	307,579	(156,729)	150,850
Net Income	$ (12,485)	$ (10,670)	$ (23,155)

REVENUE REQUIREMENT DETERMINATION

As stated earlier, based on its adjusted test year non-gas operating expenses, Frontier calculated a base rate revenue requirement of $171,421. Having considered Frontier's revised rate proposal, including the determination of its revenue requirement, the Commission finds the revised proposal to be reasonable except for its omission of a provision for income taxes.[5] Incorporating such a provision increases Frontier's base rate revenue requirement by $4,904, to $176,325.

RATE DESIGN AND RATES

The Commission has considered Frontier's proposal to consolidate the rates of its farm tap systems and the proposal to change the rate design from using a minimum bill to using a customer charge and finds those proposals to be reasonable. We will accept the rates contained in Frontier's revised proposal with the exception of the $3.84 volumetric rate. The increase of $4,904 to Frontier's revenue requirement to include a

[5] This omission was addressed with Frontier during the March 28, 2012 Informal Conference with Commission Staff.

provision for income taxes results in a revised rate of $4.00 per Mcf. Frontier's resulting rates are as follows:

Monthly Customer Charge	Per Mcf Volumetric Rate Base Rate	Gas Cost	Total
$10.00	$4.00	$3.60	$7.60

GAS COST ADJUSTMENT MECHANISM

In its application, Frontier described the nature of its farm tap operations and explained why it believed a gas cost adjustment ("GCA") mechanism was appropriate. Initially, Frontier indicated it would propose a GCA mechanism in Case No. 2011-00443, the pending case in which it plans to consolidate rates of the gas distribution systems it has acquired in Kentucky.[6] However, due to other matters causing it to delay filing its application in that case, by the time of the March 28, 2012 Informal Conference in this case, Frontier and Staff agreed that the issue of a GCA for Frontier's farm tap operations should be addressed as part of this case.

Frontier purchases the gas to supply its customers from another source and concluded that it needs a GCA to pass through the cost of gas to its customers. Because it will acquire gas under fixed price contracts, it will file GCA adjustments only when it enters into a new contract. Such a "basic" GCA, being based on known, fixed prices, will not require the adjustment components typical in a conventional GCA which generally provides for quarterly applications to be filed with the Commission. Frontier should use the GCA tariff format attached as Appendix B to this Order, and should file

---

[6] An application has not yet been filed in Case No. 2011-00443, only Frontier's Notice of Intent to file, which was received by the Commission November 4, 2011.

this tariff sheet at the same time it files its compliance tariff resulting from the revised rates approved herein.

SUMMARY

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates in Appendix A to this Order are fair, just, and reasonable, in the public interest, and should be approved effective for service rendered on and after the date of this Order.

2. The GCA tariff format included in Appendix B to this Order should be approved for use by Frontier on and after the date of this Order.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Frontier are denied.

2. The rates in Appendix A, attached hereto and incorporated herein, are approved for service rendered by Frontier to its paying farm tap customers on and after the date of this Order.

3. The GCA format in Appendix B, attached hereto and incorporated herein, is approved for use by Frontier for adjusting the gas cost charged its paying farm tap customers on and after the date of this Order.

4. Within 20 days of the date of this Order, Frontier shall file its revised tariff sheets with this Commission showing their effective date, the date of issue, and a statement that they are issued pursuant to this Order.

By the Commission

ENTERED

MAY 30 2012

KENTUCKY PUBLIC SERVICE COMMISSION

Commissioner Breathitt is abstaining from this proceeding.

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2011-00513 DATED MAY 30 2012

The following rates and charges are prescribed for the customers served by Kentucky Frontier Gas Company, LLC. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Monthly
Customer Charge

$10.00

	Base Rate	Gas Cost Rate	Total Rate
All Mcf	$4.00	$3.60	$7.60

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2011-00513 DATED MAY 30 2012

FOR ______________________________
Community, Town or City

P.S.C. KY. NO. ______________________

__________SHEET NO.______________

Kentucky Frontier Gas LLC
____
(Name of Utility)

CANCELLING P.S.C. KY. NO.____________

__________SHEET NO.______________

Gas Cost Adjustment Clause

The rates for farm tap service authorized herein are based on the wholesale cost of gas to Kentucky Frontier Gas LLC as computed using rates of its wholesale supplier currently in effect. In the event there is an increase or decrease in wholesale gas cost, Kentucky Frontier shall file with this Commission the following information within 30 days:

1. A copy of the contract or wholesale supplier notification effecting the change in rate and a statement relative to the effective date of such proposed change.
2. A statement setting out gas sales for the most recent 12 months.
3. A statement setting out the details of gas purchased for the most recent 12 months showing billing from the supplier under the most recent rate and under the proposed supplier rate.

   The difference between the amounts so determined shall be divided by Kentucky Frontier's sales for the most recent 12 months, provided Kentucky Frontier's line loss for the same 12 month period does not exceed five percent. If line loss exceeds five percent, the difference shall be divided by allowable sales calculated as (purchases x .95).

   The unit charge or credit so determined, expressed in dollars per thousand cubic feet (Mcf), shall be the Gas Cost Adjustment and used for the establishment of a new base supplier gas cost rate.

In the event that the Company receives from its supplier a refund, bill adjustment, or credit of amount paid to such supplier in respect of a prior period, Kentucky Frontier will apply to the Commission within 30 days for authority to make adjustments to the rates charged to its farm tap customers under this provision as follows:

DATE OF ISSUE______________________________
Month / Date / Year

DATE EFFECTIVE____________________________
Month / Date / Year

ISSUED BY_________________________________
(Signature of Officer)

TITLE_____________________________________

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION

IN CASE NO. ________________DATED ___________

FOR ______________________________
Community, Town or City

P.S.C. KY. NO. ______________________

____________SHEET NO.____________

Kentucky Frontier Gas LLC
____
(Name of Utility)

CANCELLING P.S.C. KY. NO.__________

____________SHEET NO.____________

1. The "refundable amount" shall be the amount received by Kentucky Frontier as a refund. Such refundable amount shall be divided by the Mcf volume of gas that Kentucky Frontier estimates it will sell to its customers during the four-month period commencing with the first day of the month following receipt of the refunds, thus determining a "refund factor".
2. Upon Commission approval, Kentucky Frontier will reduce by the refund factor any Gas Cost Adjustment that would otherwise be applicable during such period.
3. In the event of any large or unusual refunds, Kentucky Frontier may apply to the Commission for the right to depart from the refund procedure set forth herein.

Upon receipt of the required information, the Commission shall review the proposed increase, reduction, or refund and, within 30 days from receipt of the information required, issue its Order setting out the proper revised farm tap rates or otherwise acting to investigate or suspend the proposed rates.

DATE OF ISSUE______________________________
Month / Date / Year

DATE EFFECTIVE______________________________
Month / Date / Year

ISSUED BY______________________________
(Signature of Officer)

TITLE______________________________

BY AUTHORITY OF ORDER OF THE PUBLIC SERVICE COMMISSION

IN CASE NO. ____________________DATED ____________

Honorable John N Hughes
Attorney at Law
124 West Todd Street
Frankfort, KENTUCKY 40601